

**ECONOMIC RESEARCH – MARCH 2026**

**INVESTMENT INSIGHT UK**



- ✓ **Sharp rebound in bond yields**
- ✓ **Changes in expectations for the pound sterling**
- ✓ **Real estate penalized by the rate reversal**
- ✓ **Negative outlook for the FTSE 250 in H1 2026**

**THE BOE'S CURRENT STANCE IN THE FACE OF THE INFLATIONARY THREAT**

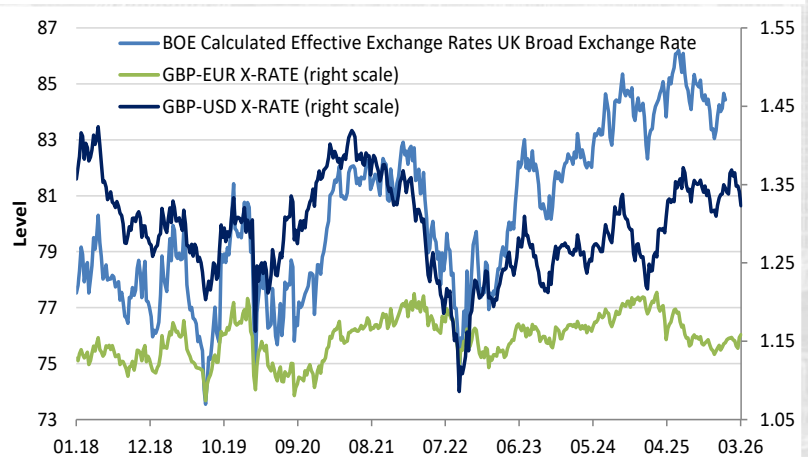
**Sharp spike in sovereign and corporate bond yields**

The UK gilt market is experiencing volatility reminiscent of the 2022 mini-budget crisis, with two-year yields surging to 4.12% and ten-year rates crossing the 4.40% threshold. This aggressive repricing reflects a wholesale capitulation by investors who have abandoned hopes for near-term rate cuts in the face of persistent inflationary pressures. The suddenness of this move has generated significant unrealized losses for existing bondholders while simultaneously raising the "refinancing wall" for indebted corporations.

**Widening credit spreads and rising default risks**

Risk premiums on corporate bonds have expanded by over 45 basis points in just a fortnight, signaling extreme market nervousness regarding the ability of firms to service debt. The high-yield segment has been hit hardest, with yields breaching 8.5% and Moody's forecasting a doubling of the corporate default rate to 6.8% by early 2027. With over £100 billion in maturities looming over the next eighteen months, a prolonged freeze in the primary market is accelerating value destruction across the private sector. This liquidity drought is particularly dangerous for small-to-medium enterprises that lack diverse funding sub-channels.

**Pound effective exchange rates**



Sources : Bloomberg, BBGI Group

## Paradoxical sterling strength and structural weakness

The British pound has recently traded above 1.34 USD, a strength driven primarily by the Bank of England's "higher for longer" interest rate signaling. While this provides temporary yield support, it severely undermines the price competitiveness of British exports, especially as the EUR/GBP cross plunges toward 0.8420. However, the UK's structural current account deficit, expected to hit 3.80% of GDP, remains a critical vulnerability that leaves the currency exposed to sudden downward corrections. Long-term safe-haven flows continue to favor the dollar, suggesting that the pound's current resilience may be a temporary anomaly rather than a fundamental shift.

## Real estate contraction and mortgage rate shocks

The residential market has shifted from caution to deep concern as average two-year fixed-rate mortgages have climbed back to 4.87%. Transaction volumes have plummeted by 20% year-over-year, and house prices recorded an unexpected monthly drop of 1.5% in February as buy-to-let landlords exit the market under tax and interest pressures. Commercial real estate is suffering a similar fate, with record vacancy rates in the City driving an 11% sell-off in major property companies. Knight Frank now projects a total valuation decline of 6.8% for 2026, ending any hopes of a swift recovery for first-time buyers.

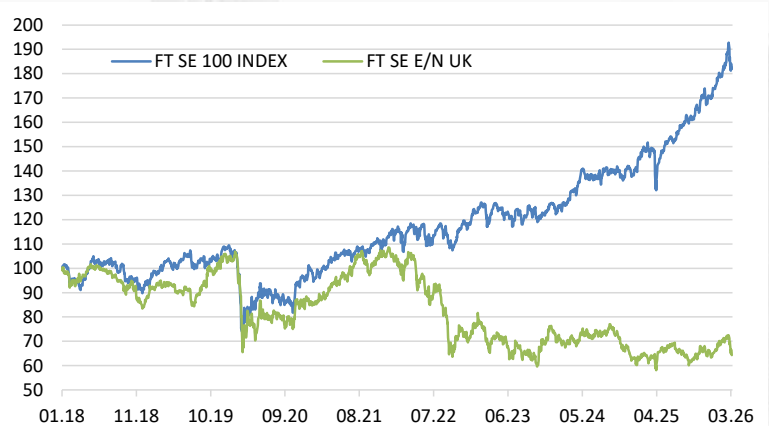
## FTSE performance divergence amid stagflation

London's flagship indices are grappling with a severe lack of macroeconomic visibility, with the FTSE 100 dropping toward 10,200 points despite the support of heavyweights in the energy and defense sectors. While giants like Shell and BAE Systems benefit from the geopolitical climate, valuation multiples across the broader market are being crushed by rising bond yields. This environment necessitates a highly selective investment approach, prioritizing companies with absolute pricing power over those sensitive to the looming stagflationary cycle. The absence of organic growth potential means that dividend yields will likely become the primary driver of total returns for the foreseeable future.

## Negative outlook for the FTSE 250

The FTSE 250, a more accurate barometer of the UK's internal economic health, has erased all gains since July 2025 with a 7% decline since the start of the year. Earnings per share (EPS) revisions are trending downward as domestic companies struggle with a combination of zero growth, high energy costs, and contracting profit margins. Even with favorable price-to-earnings ratios compared to European peers, the index faces significant headwinds as institutional investors reduce their exposure to the UK's domestic volatility. We maintain a cautious recommendation, as the downward pressure on domestic corporate profits is expected to intensify throughout the first half of 2026. This trend reflects a broader lack of confidence in the ability of mid-cap firms to navigate a prolonged high-rate environment.

UK equities and securitized real estate



Sources : Bloomberg, BBGI Group